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UNITED STATES BANKRUPTCY COURT

SOUTHERN DISTRICT OF NEW YORK

Case No. 12-12020-mg

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In the Matter of:

RESIDENTIAL CAPITAL, LLC, et al.,

Debtors.

- - - - -x

United States Bankruptcy Court

One Bowling Green

New York, New York

July 30, 2013

10:05 AM

B E F O R E:

HON. MARTIN GLENN

U.S. BANKRUPTCY JUDGE

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2 (CC: Doc# 4289, 4290, 4291) Motion of the Ad Hoc Group of
3 Junior Secured Noteholders for Entry of an Order (i) Directing
4 Each of Debtors' Counsel, Including Morrison & Foerster LLP,
5 Official Committee Counsel, Including Kramer Levin Naftalis &
6 Frankel LLP, and the Debtors' Management to Remain Strictly
7 Neutral in Any Dispute Regarding Claims by and Between Any
8 Debtors, (ii) Ordering the Limited Disqualification of Each of
9 the Foregoing to the Extent Necessary to Effectuate the
10 Foregoing, and (iii) Granting Related Relief.
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1 P R O C E E D I N G S

2 THE COURT: Please be seated. We're here in
3 Residential Capital, number 12-12020. Mr. Lee?

4 MR. LEE: Good morning, Your Honor. Gary Lee from
5 Morrison & Foerster, representing the debtors. Your Honor,
6 we're here on just one motion this morning, which is the motion
7 brought by the ad hoc group for -- I think they're defining it
8 as plan neutrality on the part of the debtors.

9 So I think I should turn it over to the movant, unless
10 you want me to address anything?

11 THE COURT: No. Mr. Shore?

12 MR. LEE: Thank you, Your Honor.

13 MR. SHORE: Thank you, Your Honor. Chris Shore from
14 White & Case on behalf of the ad hoc group. And let me thank
15 the Court for agreeing to hear this motion on such short
16 notice. And we're cognizant that we have limited time today.
17 Because of that, I'll try to keep it brief, but making sure I
18 answer any questions you have.

19 I'd like to cover three areas: one, defining the
20 issue that concerns us, because the objecting parties in their
21 papers muddy the waters a bit there. Two, addressing what we
22 see as the prejudice to the estates and the creditors that the
23 problem is causing. And three, to discuss the remedies, and in
24 particular Your Honor's question about what are the remedies
25 here, given the timing and the posture of this case.

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1 I'd like to save for reply, responding to charges that
2 this was delayed or that we waived any rights. I think the
3 opposition papers are a little bit inconsistent as to when they
4 thought the problem arose and when the motion should have been
5 brought. I'd like to hear what they have to say before I
6 respond to that. And then to deal with any accusations on
7 their part that this is just purely tactical on our part. As I
8 said, I'm happy to answer any questions the Court has along the
9 way.

10 Let me define the problem that the motion seeks to
11 address. When I use that construct, I'm not talking about
12 whether or not there are actually conflicts between the estates
13 right now. There are conflicts right now. No one disputes
14 that prior to the plan being confirmed, the estates have
15 material claims between each other, in the form of intercompany
16 claims, claims to an allocation of the Ally proceeds, and
17 allocation of expenses, are the main interdebtor issues, and
18 there are a few others.

19 No one disputes that depending on how one resolves
20 those issues, the location of distributable value within the
21 enterprise will change; that some estates will have more assets
22 to distribute to their creditors, some estates will have less.
23 And no one's disputing that it is a zero-sum game. To the
24 extent that one estate wins in a litigation over an interdebtor
25 dispute, or even a settlement of an interdebtor dispute, some

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1 other estate is going to lose.

2 Though that conflict raises problems of
3 disinterestedness, professional ethics, and fiduciary law, what
4 the objecting parties are saying in their papers is that the
5 problem isn't that dire, because in the end, all the estates
6 will win. The estates have agreed to an allocation which is
7 supported by a number of creditors. And if the confirmation
8 order is entered, and if the global settlement is approved, all
9 estates will win. We understand that's a confirmation issue.
10 Whether the global settlement is a good settlement is not
11 something that is the subject of this motion.

12 The subject of this motion is the problem that's
13 created by litigating interdebtor conflicts prior to getting
14 approval of that settlement. The estates have settled or have
15 agreed to settle. But as the Court noted in connection with
16 the PSA, that settlement is not approved yet. At the same
17 time, the debtors, the professionals, and the committee, are
18 taking litigation positions that clearly benefit one estate and
19 harm another; benefit one set of creditors of estates, and harm
20 another set of creditors.

21 The Court knows that more than a month ago, now, we
22 sent a letter asking the debtors how they proposed to deal with
23 that issue prior to the settlement being approved. They still
24 have not engaged at all. They've instead shifted back and
25 forth as to what they intend to do at confirmation and what

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1 they intend to do prior to confirmation, with respect to
2 handling the interdebtor conflicts. And we have no choice,
3 because they have constantly shifted, but to come into the
4 Court and seek a resolution now; to have the Court establish
5 the ground rules by which the estates aren't going to be
6 prejudiced before the Court hits the gavel on the global
7 settlement.

8 As best we can piece together, this is what the
9 debtors and the committee, as joint plan proponents, are
10 planning to do. At confirmation they will be seeking to have
11 the global settlement approved. That's not a problem. But at
12 confirmation they will also be seeking a specific determination
13 by this Court that, in fact, the intercompany claims lack merit
14 and have no value, and that therefore, that particular aspect
15 of the settlement should be approved.

16 THE COURT: Let me ask you. Is it that they're
17 arguing that the intercompany claims have no value or that it
18 is in the best interests of the estates to avoid the cost,
19 time, and burden of litigating the intercompany claims, and
20 that it's in the best interests of the estate to seek
21 confirmation of a plan that embodies the terms of the PSA?

22 I don't understand them to be saying that the claims
23 have no value. The plan proposes to settle the claims at zero.
24 That's very different than saying the claims have no value.

25 MR. SHORE: This is why we're here on this motion.

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1 THE COURT: Do you agree or disagree with what I just
2 said?

3 MR. SHORE: I disagree. They are going for the
4 former. I've had numerous discussions. They have made it
5 clear that at confirmation, they want, as part of the
6 confirmation findings, that the intercompany claims have no
7 value and should be waived, discharged, and canceled.

8 What are we supposed to do with that? They want to
9 put on evidence at confirmation that the intercompany claims
10 have no value, we believe, as an attempt to litigate the issue
11 of adequate protection that I've raised with the Court before,
12 which is that if the claims are worth zero, they say they don't
13 need to compensate us for the loss of our collateral. They
14 want to do that trial on a 9019 standard, and they want to put
15 on evidence before the Court -- that is the committee and the
16 debtors -- that the intercompany claims have no value.

17 It is a litigation tactic by them. And quite frankly,
18 their failure to come forward to this Court and say exactly
19 what you said in the second part, we are not touching at all
20 the merits of the intercompany claims; it's our position
21 that --

22 THE COURT: Well, are touching the merits of the
23 intercompany claims. They're resolving a dispute -- this is
24 what I understand their position to be, and they'll tell me if
25 I misunderstand it. They're resolving complex disputes as to

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1 the value of the intercompany claims. They propose to resolve
2 it by valuing -- for settlement purposes, by valuing those
3 claims at zero. That to me is different than saying the claims
4 have no value.

5 MR. SHORE: Right. And where your qualifier is, and
6 the reason we're here is that "for settlement purposes" has
7 never been part of their lexicon on this. What they are
8 saying -- we have offered very clearly to say -- and I'll say
9 it again now, I think for the third time on the record -- if
10 they want to wait and try the issue as to whether or not the
11 intercompany claims actually have value --

12 THE COURT: Mr. Shore, how many times do I have to
13 tell you that we are not waiting; that we are going to deal
14 with this issue as part of confirmation. You have repeatedly
15 tried to derail the process in this case, specifically by
16 putting off the issue of the settlement of the intercompany
17 claims. That is off the table.

18 If the parties come to an agreement, including the
19 JSNs, about a different proposed schedule, I will entertain it.
20 But as of now, we are moving forward. So don't dwell on your
21 proposal, which I have rejected on numerous occasions, that
22 resolution of the issue of intercompany claims should be put
23 off until after confirmation. It's off the table.

24 MR. SHORE: All right. And that causes the problem
25 that we have. Because as part of that litigation, there needs

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1 to be a determination as a matter of fact that the intercompany
2 claims have no value.

3 THE COURT: I disagree. I don't understand that
4 that's their position. You keep -- you sound like a broken
5 record on this point, but a 9019 does not make a determination
6 on the merits whether claims do or don't have value. I won't
7 recount the standard of a 9019. You may not like the approach
8 they've adopted. You're going to oppose it. That's fine. It
9 may or may not be approved.

10 There are definitely substantial litigable issues
11 regarding whether it will be approved. But --

12 MR. SHORE: Your Honor --

13 THE COURT: -- that's not the standard for a 9019. I
14 don't have to try the issue of whether specific intercompany
15 claims have value or not.

16 MR. SHORE: I agree with you wholeheartedly, Your
17 Honor. I'm -- the reason I am a broken record in this point is
18 not because of the 9019 issue. I agree. The Court -- and the
19 ad hoc group agrees -- the Court does not need to make a
20 specific finding in connection with 9019 that the intercompany
21 claims are, in fact, worth zero. We are not fighting that, and
22 that's not why I'm here.

23 The reason I am here is because the adequate
24 protection argument, the claim we have asserted in the
25 litigation, that you can settle the intercompany claims for

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1 whatever you want, provided you have the statutory basis to
2 settle a claim on which we have a lien -- but you can do
3 that -- but if it causes a diminution in the value of the
4 collateral, we are entitled to adequate protection. That is
5 going to require a factual finding as to whether the
6 intercompany claims had value at the time they were settled for
7 zero.

8 I have said let's push that off post-confirmation.
9 The only reason I'm raising that again is because the debtors
10 and the committee have rejected that offer. They have said no.
11 We want to actively litigate that issue at confirmation and we
12 want to, in fact, seek a factual finding from this Court that
13 the intercompany claims have no value. That's the problem we
14 have.

15 And it's their insistence that this issue be tried at
16 confirmation with MoFo, Kramer Levin, and Mr. Kruger, and the
17 other debtors' management, to the extent they were involved,
18 that is causing the problem here. And the problem is that
19 before that settlement is approved on a 9019 standard, we're
20 going to be litigating the issue of whether the intercompany
21 claims actually have merit. Why they would want to try that
22 issue at the same time they're trying to settle is probably
23 only explainable by that's the position that they think is
24 going to provide the greatest leverage in the litigation. You
25 wouldn't normally see that in the context of a 9019, because

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1 the law is so clear. You do not have to make a determination
2 that the claims are, in fact, worth zero.

3 Their explanation -- and let me start with a basic
4 point on prejudice. It's the obligation of the fiduciary who
5 is in conflict to avoid causing any prejudice to his or her
6 charges. The only explanation we have -- I guess we've
7 received two explanations from the objecting parties as to how
8 they're going to avoid the prejudice of actually litigating the
9 intercompany claims, while trying to settle the intercompany
10 claims -- is one, that they're going to resolve it all in a
11 manner that benefits all the estates. That is, we can litigate
12 all we want over the intercompany claims, but at the end of the
13 day, it's going to benefit everybody that we just get the
14 global settlement done.

15 The problem is with that, that the proposed settlement
16 doesn't solve the problem. As the Court said in Project
17 Orange, when DLA made an argument that we're settling with our
18 other client in a manner that benefits everybody, the Court
19 said that DLA was severely mistaken that the settlement of a
20 conflict, even if it's a good settlement, resolves the
21 conflict. They can't bootstrap their way into saying there is
22 no conflict because the conflict is going to be resolved in a
23 manner that benefits everybody.

24 THE COURT: The issue in Project Orange was an alleged
25 conflict between the debtor and the largest single creditor in

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1 the case with arguably divided duties between a client in the
2 bankruptcy case and a significant client that was a creditor in
3 the case. Here, the debtors' counsel and the committee's
4 counsel have fiduciary duties -- I agree with this point --
5 their fiduciary duties extend to creditors of all of the
6 debtors, not just the one. But this is not the same as Project
7 Orange.

8 MR. SHORE: The debtors are proposing as follows, for
9 example: with respect to RFC, Residential Funding; RFC has a
10 two-billion-dollar intercompany claim into ResCap, LLC,
11 which -- an entity which they are also representing. It is the
12 largest single asset of RFC, other than its claim to the Ally
13 contribution. They are proposing that RFC, as part of a global
14 settlement, release its claims against ResCap, LLC, based upon
15 advice that has been provided that that claim lacks substantive
16 merit.

17 Analytically, it's exactly the same as Project Orange.
18 Their largest client, ResCap, LLC, is also their client in the
19 context of representing RFC. So analytically, it's not
20 different. I'm going to come to a little bit in what's the
21 solution in the bankruptcy court. But the conflict exists, and
22 they don't get away from the conflict by saying, but that claim
23 is being resolved as part of a global settlement that benefits
24 both ResCap, LLC and RFC. It just begs the question.

25 And it comes to what is really their proposal to avoid

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1 prejudice, which is one I've not heard before, which is let's
2 try it. We're going to come forward at confirmation with
3 evidence about the value, for example, of the RFC claim into
4 ResCap, LLC, and we'll point out the many deficiencies that we
5 see in that claim: the lack of existence of a note, the --
6 we'll have our interviews with management as to what they
7 expected. We will claim privilege with respect to materials we
8 have provided. And we're going to litigate that case. And if
9 it turns out that the Court disagrees that the global
10 settlement doesn't benefit everybody, we'll just do a do-over.

11 No court has ever said that that avoids the prejudice
12 of a conflict. And outside of a bankruptcy court, I can't
13 imagine a New York lawyer standing up and saying the time to
14 resolve my conflict is after I've tried the case and the Court
15 has determined that there was a taint in the process. They
16 can't -- can't, as New York lawyers or as fiduciaries in the
17 bankruptcy court, appear and be heard with respect to the
18 merits of intercompany claims prior to the settlement occurring
19 and prior to each of the estates getting the releases, because
20 in connection with that litigation, as good litigators will do,
21 they will present the evidence that benefits the global
22 settlement. They will not -- or try to avoid discovery,
23 legitimately, of issues that work against the global
24 settlement.

25 What are they going to do, for example, with the

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1 memorandum or the legal advice that they disclose in the
2 disclosure statement? Morrison & Foerster provided advice to
3 Mr. Kruger which was shared with the committee that laid out
4 that the intercompany claims had issues with them. If that
5 memorandum contains information which is beneficial to an
6 estate like RFC, are they going to withhold that on privilege
7 grounds? Are they going to advocate -- stand up in front of
8 the Court and say, Your Honor, I do not want that memorandum
9 turned over in the context of litigation; it is an attorney-
10 client document; even if they know that that memorandum
11 contains information which is contrary to the global
12 settlement?

13 They have softened their position to some extent in
14 the -- the debtors have, in the papers. They're now not
15 claiming that every single intercompany claim lacks any merit,
16 that in fact, if all the claims were litigated in that giant
17 matrix that they have published, they would all reasonably
18 result in a zero recovery. They're arguing, I think, now, that
19 each one is going to have to be analyzed individually, if what
20 we were really trying to do is an estate-by-estate judgment on
21 the settlement.

22 But what they're saying is, on a global basis it makes
23 sense to do that. Again, that's a confirmation issue as to
24 whether or not on a global basis it makes sense. But it's a
25 today issue if what they're trying to do is as part of the

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1 confirmation appear and be heard in an active litigation over
2 the merits of the intercompany claims.

3 It should be noted they did answer the complaint.
4 That's -- that had individualized allegations with respect to
5 intercompany claims. MoFo did, one counsel, came in and denied
6 the allowability of one set of claims that was asserted against
7 another debtor. And I'll come to the remedy in a bit, because
8 we're in bankruptcy court.

9 But there is clearly a conflict there, and there's
10 clearly prejudice when one counsel denies the allowability of
11 claims asserted by a creditor in that estate, particularly when
12 that same counsel is counsel to the creditor. That's the
13 problem we see.

14 So the question is, from my perspective, really,
15 what's the remedy? Outside of bankruptcy, I don't think --
16 reading Greene closely and its progeny in the New York State
17 courts -- that in these circumstances, given the materiality of
18 the claim, anybody would allow a waiver of the conflict to
19 allow Morrison & Foerster to appear and be heard in an active
20 litigation in the RFC claiming two billion dollars from ResCap,
21 LLC.

22 But there has been no waiver here by the estates. And
23 I want to distinguish the waiver point which I'll discuss
24 later, that maybe we did something that waived the conflict.
25 The estates haven't waived any conflict against each other.

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1 The oppositions don't say that one exists. The waiver would
2 have to be disclosed fully to the Court. The underlying
3 conflict would have to be disclosed fully to the Court. The
4 Court would have to approve a waiver: ResCap, LLC hereby
5 consents to allow Morrison & Foerster to represent other
6 debtors in connection with the actual litigation of
7 intercompany claims. And then the Court would have to modify
8 the retention orders in the case to allow the lawyers to appear
9 and be heard and represent an interest adverse to each
10 individual estate.

11 So there hasn't been an actual waiver. The question
12 is, we're in bankruptcy; we recognize the cases have progressed
13 to a certain point; we recognize the consequence of a
14 disqualification at this point. So the question is, what's the
15 appropriate remedy?

16 We haven't sought a wholesale disqualification. We
17 have not sought the appointment of fifty-one sets of counsel.
18 We have not sought the appointment of an examiner to look into
19 this. We have not sought the appointment of trustees. All
20 remedies that have been imposed at various stages of various
21 cases that have progressed along. All we've done is ask them
22 to change their plan strategy. They should not, under any
23 circumstances, prior to confirmation of the plan and an
24 approval by the Court of releases between the individual debtor
25 estates, should not be allowed to appear and be heard on the

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1 interdebtor conflicts. They should not be able to represent
2 each of the individual estates in the litigation of that issue.

3 Now, maybe that causes them to say, you know what,
4 let's have a discussion about pushing this until after
5 confirmation. But it's their insistence that that issue be
6 tried at confirmation that's causing the problem.

7 So if they want to do that litigation still at
8 confirmation, then they have to stay neutral in it, and
9 somebody else is going to -- consenting creditors or otherwise,
10 is going to have to take up the oar on a litigation over
11 whether or not the intercompany claims or interdebtor claims
12 are all, in fact, worth zero.

13 And in connection with that, the debtors have to make
14 a full and fair disclosure of the conflict and the issues and
15 what it means for each of these estates to be releasing their
16 intercompany claims against the other. And leave it for the
17 creditors to approve it; to have a 9019 and have it be able to
18 come before the Court and say the global settlement is a good
19 global settlement. And they can advocate exactly what you
20 said, that the litigation associated with this would be timely
21 and consuming and all-consuming. And they're complicated
22 issues. And we believe -- Mr. Kruger believes that as a
23 fiduciary for all estates, it benefits all estates for it to be
24 settled.

25 And we'll have it out at confirmation, if in fact, we

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1 disagree with that. But what they can't do is appear and be
2 heard and say on behalf of ResCap, LLC -- or in the instance I
3 gave, on behalf of RFC -- I believe that the claim that RFC has
4 into ResCap, LLC, based on the advice of counsel, is subject to
5 material challenge and would never be allowed in the court.
6 And even if it were allowed, it would be recharacterized. And
7 even if it were recharacterized as equity, there would be no
8 fraudulent conveyances that occurred when RFC transferred two
9 billion dollars of value up to ResCap, LLC.

10 So there needs to be a lot of disclosure around the
11 intercompany claims. And they have to, in the end, be more
12 sensitive about the conflict position that they are in. They
13 can't be coming in and taking the position -- let me say it
14 this way. If you look at all the cases that have dealt with
15 interdebtor conflicts in the context of a bankruptcy case, from
16 a -- when they come up in the context of a retention issue or
17 they come up in the middle of the case or they come up at
18 confirmation, where the cases all seem to go, given that we are
19 in bankruptcy court and there are the interests of, in this
20 case, tens of thousands of creditors that need to be kept in
21 mind, the courts come out with the following precept. While we
22 recognize counsel and the debtors are going to have a role in
23 resolving interdebtor conflicts, and can manage the process and
24 can act as an honest broker, they just can't flout the rules.

25 When people get into trouble is when they deny that a

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1 conflict exists or they argue that the conflict has been waived
2 or they try to release the claims in order to avoid the
3 conflict. That's when people get into trouble. Because at
4 that point, what they're saying is, the rules don't apply; that
5 because I am in bankruptcy court --

6 THE COURT: I haven't read anything to suggest they're
7 releasing the claims to avoid a conflict. So I don't know
8 where you get that from other than you've made it up.

9 MR. SHORE: I'm not -- I wasn't attributing that to
10 the debtors here. I was attributing it to --

11 THE COURT: Let's deal with the case I have before me.

12 MR. SHORE: Okay. The case you have before you. The
13 position they have taken is the conflict was waived. It wasn't
14 an actual waiver, knowing written waiver that was approved by
15 the Court. But the conflict was waived because of the passage
16 of time.

17 That is not a supportable position. They've taken the
18 position that because we have filed a tactical motion they
19 don't have to respond to the issues --

20 THE COURT: You know, I understand the law with
21 respect to sanctionable conduct, that a motion, for example,
22 that has elements of validity, if filed for an improper
23 purpose, can result in sanctions being imposed. It doesn't --
24 the outcome of a -- and there is no sanctions motion before me.
25 But the outcome of a sanctions motion doesn't hinge upon

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1 whether there were a fair ground for litigating the issues that
2 are raised by a motion. If it's established that the motion
3 was filed in bad faith, that may be sufficient in and of
4 itself. Do you agree or disagree with that?

5 MR. SHORE: Well, the Second Circuit came out with a
6 case, six, seven years ago, maybe longer, on that issue, which
7 is whether or not a proper motion brought for an improper
8 purpose is sanctionable, and I believe said that the issue is
9 one that needs to -- that requires close inspection by the
10 Court in the context of resolving it and did not rule out of
11 hand that a proper motion brought for an improper purpose was
12 in fact -- could, in fact, be the subject of a sanctions
13 motion.

14 THE COURT: Go ahead, Mr. Shore.

15 MR. SHORE: Okay. So let me address the issue now,
16 which is the one of tactics.

17 The position that they are taking here is that we --
18 not that we have no basis, I think, to bring this issue to the
19 Court's attention, but rather we're doing it in order to foster
20 our position in the litigation. Not -- and although they seem
21 to say it, I don't think anybody clearly comes out and says
22 tactic -- tactical is an outright defense to a conflicts
23 motion. In fact, I think that the Second Circuit has spoken on
24 that as well, saying that's why motions like this are
25 disfavored. It just requires the Court to scrutinize them more

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1 closely.

2 But what they're saying is you're bringing this motion
3 to blow up the global settlement, because the global settlement
4 has a provision which says "waive, cancel and discharge
5 intercompany claims". That's not what we're doing.

6 If the motion said --

7 THE COURT: Well, it's easy for you to say, but it's
8 certainly -- I must say -- I'm not making any determination
9 about it, but there would appear to be support for the position
10 of the debtors and the committee that your motion and the
11 timing of the motion is filed for an improper purpose, for the
12 purpose of blowing up the PSA and the proposed plan. And
13 that's different, and I've said repeatedly, that the issues of
14 whether the proposed settlement are approved as part of the
15 plan raise litigable issues, and the Court will deal with them
16 on the merits as part of confirmation. Okay?

17 So I'm not making any decision whether the motion was
18 or was not filed in bad faith. But it seems to me that in the
19 multiple oppositions to your motion that have been filed,
20 credible arguments that the motion was filed at this time, in
21 these circumstances, in bad faith, also present litigable
22 issues.

23 MR. SHORE: So let me address, then, the concept of
24 timing. The objecting parties have been all over the lot as to
25 when the conflict arose or when we should have brought the

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1 motion. Ally, I think, has it at the earliest period of time,
2 which is that at the time of the retention of Morrison &
3 Foerster, the issue should have been raised. Filing a motion
4 then just raises a string-sight response, the mere existence of
5 intercompany claims does not present a conflict issue. Among
6 other things, nobody had done any diligence into what the
7 disputes were around that. But also, it wasn't clear that
8 there was going to be any value associated with intercompany
9 claims, depending on what the distributable value is within the
10 estate. So that's too early.

11 Was it when the schedules were filed? The schedules
12 say this is our best work at the time, and as the debtors point
13 out, it could go this way, it could go that way. This is the
14 math. They did schedule them as allowed claims.

15 Was it when the debtors started having discussions
16 about intercompany treatments, not publicly? No, because it's
17 still -- at that time, it's unclear whether or not intercompany
18 claims, if litigated, mean anything in the context of the case.

19 The cases are clear, the conflict arises when the
20 dispute is one of both fair dispute, that is, there's an issue
21 here as to whether or not the claims should be allowed as debt
22 claims or should be recharacterized as equity, and if
23 recharacterized as equity they should be -- there should be a
24 Chapter 5 analysis that's associated with them, one. And two,
25 that it matters; that it affects creditor recoveries.

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1 Before the Ally settlement occurred, as Your Honor may
2 recall, there was a question as to whether unsecured creditors
3 were going to get anything in the context of this case, or
4 whether these cases were going to go into administrative
5 insolvency, in which case, the intercompany claims don't
6 matter. They're not going to get paid any more than any other
7 creditor was going to get paid.

8 When the issue arose was when, as the result of the
9 mediation, they published a document, the PSA, which says as
10 part of the global settlement, ultimately as a means to fix the
11 places in which distributable value was being put in the
12 enterprise, they were going to turn off the intercompany claims
13 and waive discharge. That's when we sent the letter. What do
14 you plan to do with that? What do you mean by that? Are you
15 really going to be litigating these issues?

16 What were we supposed to do when they didn't respond
17 and instead came in to the Court --

18 THE COURT: Let me interrupt you for this. I'm not
19 going to deal with whether -- at this stage, I'm not deciding
20 anything on the issue of whether the motion was filed in bad
21 faith. Given the limits of time, let's move on with the
22 argument.

23 MR. SHORE: Okay.

24 THE COURT: And the same will apply to --

25 MR. SHORE: So --

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1 THE COURT: -- the other side.

2 MR. SHORE: -- so I'll say this. I think the conflict
3 arose -- the position we've taken very clearly, is the conflict
4 arose at that period of time. We raised it. We've tried to
5 deal with it. We brought a motion before the Court.

6 If somebody wants to argue that the conflict arose
7 earlier, they should be addressing before the Court, when the
8 conflict was arose, and what disclosure was made to the Court
9 and other interested parties in these cases that there was, at
10 that point, a material conflict that was going to affect
11 creditor recoveries.

12 So as far as tactical is concerned, their only
13 argument is that they agreed to a provision in the PSA which
14 said that the intercompany claims would be canceled, waived,
15 and discharged; not that the intercompany claims are being
16 settled as part of this, and will receive no distribution.
17 Which is a plan construct we're very familiar with. They said
18 that.

19 Now, if the global settlement had said, as part of a
20 global settlement, in the interim up to confirmation the
21 debtors will not spend any money preserving the JSN's
22 collateral, would it have been tactical for us to move to lift
23 the automatic stay and take possession of our collateral or
24 seek adequate protection? It would have been defensive to
25 protect ourselves from them taking an action which violated the

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1 Rules.

2 If there was a provision in the PSA which says the
3 debtors shall keep secret every bit of disclosure between the
4 parties in connection with settlement, would it be tactical for
5 us to come in and seek a determination that they actually had
6 to produce that in discovery? It wouldn't be a defense to say,
7 well, we don't have to produce it in discovery, Your Honor,
8 because that would blow up the global settlement. The fact is,
9 is they took a position in the global settlement, in the PSA,
10 that said we're going to waive, cancel, and discharge. They've
11 clarified now that what that means is they're seeking a factual
12 finding at confirmation that the intercompany claims are worth
13 zero.

14 In response to that, which in our view violates the
15 Rules, we're asking the Court not to let them violate the
16 Rules. If they want to stand up and say we are not going to
17 appear and be heard at confirmation on the merits of
18 intercompany claims, I don't have a problem. They won't say
19 that.

20 And so in the absence of them voluntarily doing it,
21 and as a remedy for what is a violation of the Rules, we're
22 just asking the Court to establish the ground rules that I laid
23 out before. They're not going to do it. Somebody else can do
24 it. If somebody else does it, they have to remain neutral.
25 And throughout the entire process, they're going to have to

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1 make a lot of disclosure which allows the people, the real
2 parties-in-economic-interest on this, to make determinations as
3 to whether and how to litigate those intercompany claims.

4 Unless Your Honor has anything further, I'll sit down.

5 THE COURT: No, go ahead.

6 Just give me a moment, Mr. Lee.

7 MR. LEE: Sure.

8 (Pause)

9 THE COURT: Go ahead, Mr. Lee.

10 MR. LEE: Good morning, Your Honor. Gary Lee from
11 Morrison & Foerster, for the debtors.

12 Your Honor, at the outset, I just want to make it
13 clear, if it wasn't already apparent, that the debtors, the
14 debtors' CRO, the debtors' professional, the management, and
15 speaking for the UCC, their counsel, and the members too, take
16 their fiduciary obligations very seriously. And that is why,
17 Your Honor, we filed what we hope you saw was a fairly
18 temperate and thoughtful response to a motion that quite
19 frankly we didn't think should have been made.

20 The debtors -- and I think as Your Honor did --
21 struggled during our July 22nd conference -- struggled with the
22 timing of the motion, the motivation behind the motion, and the
23 practical import, if the relief that the ad hoc group are
24 looking for is granted. And we, like Your Honor, were left
25 wondering whether fourteen months into the case, this is really

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1 just a rather unseemly tactical approach by one group that has
2 used these precise same tactics in several cases in the
3 Southern District of New York.

4 And we believe that tactically, what they are trying
5 to achieve, Your Honor, is to really seek an end-run around
6 what Your Honor decided on July the 3rd, just before we went
7 away on vacation. And that is to challenge this Court's
8 decision to hear the global settlement -- the global
9 compromise, including the resolution of intercompany balances
10 and thirty other issues, under the Rule 9019 standard. That's
11 what this is really an attack on.

12 THE COURT: Can I ask this question? Are the debtors
13 seeking to have the Court make a finding that each of the
14 intercompany claims is valued at zero?

15 MR. LEE: No, Your Honor, what the debtors are saying
16 is something quite different from that. What we're saying is
17 that the intercompany claims lack merit -- I'm sorry, not that
18 they lack merit -- but rather that they should be settled to
19 avoid the cost, time, and burden associated with trying to
20 litigate what are, in essence, hundreds of thousands of
21 individual intercompany balances which are typically not
22 reflected by any documentation, often the result of the cash
23 management.

24 What we're trying to do, Your Honor, is to avoid the
25 months and years of litigation that were spawned in the

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1 Adelphia case, which the same counsel was involved in --

2 THE COURT: Let me stop you. Because what you've
3 articulated is essentially what I had understood what the
4 co-proponents of the plan are seeking; not a finding that the
5 intercompany claims are worth zero, but that litigation of the
6 substantial disputes would be expensive and time-consuming, and
7 that a settlement of the claims on the basis proposed is in the
8 best interests of the estates and their creditors.

9 When I asked that question of Mr. Shore, he argued
10 that no, if that's what the co-proponents were seeking, that
11 would be one situation. But rather, the co-proponents are
12 seeking a specific factual finding by the Court that the
13 intercreditor claims are worth zero.

14 So I wrote that down in my notes in multiple places
15 during Mr. Shore's presentation. He linked it to the issue of
16 adequate protection, that in order -- I understood his argument
17 to be that in order to avoid any obligation for adequate
18 protection, the co-proponents are seeking to try, as part of
19 confirmation, a valuation of the intercompany claims, and have
20 them valued at zero, not settled at zero, but valued at zero,
21 in order to avoid adequate protection. Could you address that?

22 MR. LEE: Yes, Your Honor. So just to be absolutely
23 clear, we're not taking the position that the intercompany
24 claims are worthless or meritless at confirmation. What we are
25 taking the position is that settling them pursuant to the

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1 global settlement and having them discharged as part of that
2 global settlement, at least for the purposes of the adequate
3 protection, establishes the value of the claim for all
4 purposes. That, Your Honor, we think is very different from
5 saying that if these claims were litigated today, they would be
6 worthless. That may be true, but that is not what we will be
7 seeking at confirmation.

8 Your Honor, the other obvious follow-on point from
9 that is if you open the door to intercompany claims -- and
10 let's just take the RFC example that Mr. Shore was referring
11 to -- there is indeed a two-billion-dollar intercompany
12 balance. And as reflected in the disclosure statement, that
13 intercompany balance is not documented in any way, shape, or
14 form. In fact, the documentation refers to a reverse lending
15 relationship to the intercompany balance.

16 There is equally, and equally as interesting, a
17 sixteen-billion-dollar of debt forgiveness claim coming back
18 the other way. So we're not saying that the intercompany claim
19 lacks merit, it just simply lacks documentation. But we're not
20 saying that the sixteen-billion-dollar debt forgiveness claim
21 lacks merit, but what we are saying is, if you want to open the
22 door to this, then you can open the door to debt forgiveness
23 litigation, you can open the door to substantive consolidation
24 litigation.

25 Because if this settlement falls away and somebody

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1 tries to pursue the intercompany claims, there's simply no
2 question that somebody will seek to substantively consolidate
3 these estates.

4 So what we are saying is that you can't have fifty-one
5 debtors with fifty-one separate intercompany claims, fifty-one
6 separate sub-con arguments; fifty-one separate debt forgiveness
7 claims, fighting these and every other issue for the next ten
8 years. That's why we, Your Honor, asked for a sitting federal
9 court bankruptcy judge to act as a mediator. That's why all
10 the creditors wanted to settle. And that's why, Your Honor, we
11 sought approval of --

12 THE COURT: All the creditors didn't want --

13 MR. LEE: -- the PSA --

14 THE COURT: -- to settled.

15 MR. LEE: All of the creditors apart from one. But
16 I'm sure in the fullness of time they will come to realize that
17 paying them par plus accrued pre-petition interest was quite
18 generous.

19 Your Honor, we believe that the entire process was
20 designed to benefit all of the estates. So if I may, I can run
21 through --

22 THE COURT: Let me ask --

23 MR. LEE: -- our arguments --

24 THE COURT: -- you this --

25 MR. LEE: Yes, Your Honor.

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1 THE COURT: -- because Mr. Shore stated, and I don't
2 know whether -- I'd like your response to this. He said in
3 substance that the debtors will offer evidence at confirmation
4 of the evidence of the value of the RFC claim and the
5 deficiencies in that claim. How do the co-proponents propose
6 to support a settlement of the intercompany claims? Let's
7 focus, specifically, for a moment, on the RFC claim.

8 MR. LEE: Well, Your Honor, we'll be guided by the
9 9019 standards. And we think, actually, that what we put in
10 the disclosure statement, is, in fact, a fair and fairly
11 neutral description of the issues that surround the
12 intercompany claims. So I think pursuant to 9019, what we'd do
13 is, in effect, replicate what we've done in the disclosure
14 statement and say given that and given the offsetting issues
15 that we're going to have to deal with, including, as I said, a
16 sixteen-billion-dollar debt forgiveness claim, as well as the
17 potential for sub-con, we thought that it was in the best
18 interests of all of the debtors' estates to resolve those
19 issues rather than be mired in litigation for the next five or
20 ten years. And we think that that, Your Honor, will be an
21 adequate proof for the resolution.

22 THE COURT: Go ahead.

23 MR. LEE: Your Honor, unless you want me to, I think
24 that our papers cover the five principal points that I was
25 going to make in opposition, which were, number one, there's

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1 been significant and forthright disclosure by the debtors
2 throughout this case; and in fact, I'm quite happy to address
3 some of the comments that Mr. Shore made with that -- in that
4 regard.

5 I think, Your Honor -- and many of the cases that the
6 ad hoc group refer to, including Granite, focus on the debtors'
7 disclosure failures. And that's not the case here. The ad hoc
8 noteholders have known from day-one of these cases, and in
9 fact, going back to the pre-petition period, that the
10 intercompany balances represented a gating issue to a
11 confirmable plan. And I believe that prior to the filing of
12 this case, Your Honor, we shared an analysis of the
13 intercompany balances with them which showed much the same
14 thing that's now currently filed in the disclosure statement.
15 And they knew from their own experience in the Adelphia case,
16 and obviously from what we told them, that any attempt to
17 enforce the intercompany claims balances would result in years
18 of litigation.

19 So we actually think, Your Honor, that the concept
20 that the conflict did not manifest itself until the PSA was
21 signed, is in fact, entirely inconsistent with a record that
22 goes back not just the fourteen months of this case, but prior
23 to it. Again, the ad hoc group also knew over the seven months
24 that the debtors and their CRO were participating in the
25 mediation, that the issues that we were seeking to resolve --

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1 the very issues, included the intercompany balances. And they
2 knew that because we said it in at least three different
3 filings to this Court.

4 What we believe, Your Honor, and I will be quite frank
5 about this, is that now that the plan has been filed, the ad
6 hoc group has decided that the best way to attack it, given
7 that Your Honor has indicated that the 9019 standards apply, is
8 not to attack it through confirmation, but rather to raise a
9 conflict where none exists.

10 The second point, Your Honor, is we don't actually
11 believe that a conflict exists here. And I understand there
12 are some concerns about the way in which we're describing the
13 PSA and the impact. But I think for the record, it would be
14 helpful just to walk through that.

15 Your Honor, I think that we demonstrate just how
16 seriously we take conflicts and our fiduciary obligations, is
17 that we came to this Court over the objections of the ad hoc
18 noteholders, who said you don't need these findings, as well as
19 other objectors, to seek Your Honor's blessing to enter into
20 the PSA. But it wasn't just to enter into the PSA, it was to
21 bind all of the debtors, to commit all of the debtors, to
22 prosecute a plan that we thought was in the best interests of
23 all of the estates.

24 That's why, Your Honor, we sought those findings.
25 What we did not want to do was embark on a plan, in a very

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1 complex and very expensive case, that was dead before it
2 started. And that is practically, Your Honor, what will happen
3 if the JSNs get the relief that they're seeking here.

4 There were objections to the findings, Your Honor.
5 But the fact remains, we're not hiding behind the PSA. We're
6 not looking to prejudice them by referring to the PSA. What
7 we're saying is that the PSA resolved any perceived conflict,
8 because it binds the debtors to act in unison in prosecuting
9 the plan. That's the very purpose behind seeking approval from
10 the Court to embark on a course of action.

11 So what we're saying, Your Honor, is that the ad hoc
12 committee can't use a disqualification motion to control what
13 the debtors are already permitted to do, which is to prosecute
14 the plan embodied in the PSA.

15 THE COURT: Let me ask this. Is there something in
16 the PSA that would require the Court to make an express finding
17 at confirmation that the intercompany claims are meritless and
18 are valued at zero, as opposed to approving the settlement
19 that's embodied in the plan?

20 MR. LEE: There is nothing, Your Honor. We were quite
21 careful when we were drafting the disclosure statement to make
22 it quite clear, in the face of what we understood were some
23 misunderstandings, that what we were looking for is a finding
24 that they are, in effect, settled, waived, and discharged, as a
25 result of the global settlement.

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1 Your Honor, we also don't think that the record
2 supports that the ad hoc group has met its 327(a) standards.
3 As I said, I think I've covered, we believe that there is now a
4 complete unity of interests among the debtors and their
5 estates, as Judge Lifland aptly put it in O.P.M., to pursue a
6 confirmable plan. And indeed, we think that the fact that we
7 went through a seven-month mediation in and of itself to try
8 and address these issues, is the hallmark of a nonconflicted
9 party.

10 I think -- Your Honor, and this also goes to the heart
11 of it, and it's something that you noted at the July 22nd
12 conference. Mr. Kruger, who is an acknowledged fiduciary to
13 these estates, but also a veteran of this bar, did make an
14 assessment of all of the different claims being asserted in
15 different directions that was entirely consistent with his
16 fiduciary duties. And he reached the judgment, and I think
17 it's fair to say that everybody should accept that this was a
18 good judgment, that the global settlement that brings in 2.1
19 billion dollars is in the best interests of all of the debtors,
20 all of their estates, and all of their creditors. And what we
21 will demonstrate at confirmation, Your Honor, that that is a
22 very appropriate resolution to the very complex issues.

23 THE COURT: Let me ask you. Mr. Shore, referring to
24 the disclosure statement, indicated that the Morrison &
25 Foerster memorandum to Mr. Kruger on the problems regarding the

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1 intercompany claims -- and I didn't see it in the disclosure
2 statement; I may have missed it -- but Mr. Shore suggested that
3 you've already indicated that you intend to assert privilege
4 and not produce the document. First, is there something in the
5 disclosure statement about Morrison & Foerster advice to Mr.
6 Kruger regarding the problems -- I'll use it euphemistically --
7 with the intercompany claims?

8 MR. LEE: Your Honor, could you bear with me one
9 second --

10 THE COURT: Yes, sure.

11 MR. LEE: -- I apologize. It's about 400 pages long,
12 so --

13 THE COURT: I understand that. That's why I may have
14 missed it.

15 MR. LEE: Your Honor, I now have to concede, I
16 absolutely have no idea what Mr. Shore is talking about. I
17 think he might be talking about a notional piece of advice that
18 we might have given to Mr. Kruger about any specific issues so
19 that when Mr. Kruger is testifying why he thought it was
20 appropriate --

21 THE COURT: Put that in plain English for me.

22 MR. LEE: I don't know what he's talking about. There
23 is -- there are lots of pieces of advice that we gave. And I
24 think that what Mr. Shore is addressing to what extent can he
25 invade the privilege that Mr. Kruger has in relying on our

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1 advice. And I think that what we've said, and we'll say it for
2 the tenth time, is that Mr. Kruger came to independent
3 judgments based not just on hearing what we viewed the facts to
4 be, but also the presentations, obviously, that we were
5 provided during the course of the mediation and hearing from
6 Judge Peck as well.

7 THE COURT: Okay, thank you.

8 MR. LEE: Your Honor, the last point, obviously, is
9 just to address the practical consequences of what I think is a
10 moving target of relief that are being sought by the ad hoc
11 group here. I think that the solution was -- and this was
12 raised for the first time in their reply -- that the senior
13 unsecured notes, the holders of the RMBS securities, the
14 monoline insurers, and I guess anybody else who's somewhere
15 around the debtors' capital structure, could represent
16 somebody's interests with respect to the litigation over the
17 intercompany balances.

18 It think that the first reason why that particular
19 resolution doesn't work is because, as I said, and I'll say it
20 again, the intercompany balances are not being litigated,
21 they're being settled, pursuant to 9019. And the second reason
22 why the solution is nonsensical is, Your Honor, how do we force
23 creditor constituencies to litigate this one specific issue.
24 Why doesn't it, and why won't it open the door to every other
25 single offsetting issue that we're trying to resolve through

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1 the mediation? I think it effectively undoes absolutely
2 element of progress that we've made in the last fourteen
3 months, Your Honor. So --

4 Your Honor, I think at the end of the day, I think
5 that Mr. Shore did try to cite to cases like Augie/Restivo for
6 the proposition that the debtors can't enter into a settlement
7 for the benefit of all, to the detriment of one single debtor.
8 That, Your Honor, is just simply not the effect of the global
9 settlement. That's what we'll show at confirmation. And that,
10 Your Honor, is not an issue for today.

11 We hope, therefore, Your Honor, sees this motion for
12 exactly what it is. Thank you.

13 THE COURT: Thank you, Mr. Lee.

14 Mr. Eckstein?

15 MR. ECKSTEIN: Your Honor, good morning. Kenneth
16 Eckstein on behalf of the creditors' committee. Let me make a
17 number of additional comments. I don't want to repeat what Mr.
18 Lee said.

19 We also tried to deal with this motion in a reasonably
20 constructive manner, although we continue to find the motion
21 puzzling and frankly disappointing. I'm sure it's not lost on
22 Your Honor, I think we've been before Your Honor either in a
23 motion, a status conference, or discovery conference more than
24 thirteen times in the last several weeks, really dealing with
25 JSN issues. And frankly, it's the same basic issue.

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1 And the JSNs have tried, I think, mightily, to create
2 a conflict that does not exist in this case. And the JSNs,
3 notwithstanding what they understand to be the case, which is
4 that this case, at this juncture, involves a global settlement,
5 the JSNs are intent on trying to compel a litigation of
6 intercompany issues, that is not what is happening in this
7 case.

8 There are many, many intercompany issues. And I heard
9 Mr. Shore at one point make the comment that in fact, the
10 debtors and the committee should be neutral on all interdebtor
11 issues, not just intercompany claims. I mean, theoretically,
12 that would involve every claim in the case. Because every
13 claim in the case is -- affects multiple debtors.

14 And as we all know, what was accomplished in the
15 mediation in this case was a resolution of issues that affect
16 all of the debtors, affect third-party claims, and have been
17 accomplished in the context of a comprehensive global
18 settlement. It is significant to note that there really aren't
19 multiple parties lining up behind Mr. Shore to argue that there
20 are conflicts in this case, because one of the hallmarks of the
21 plan is that there is global consensus. Now, unfortunately the
22 J --

23 THE COURT: How many creditors signed the PSA?

24 MR. ECKSTEIN: I don't have the number offhand, Your
25 Honor, but I believe every -- with the exception of the JSNs,

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1 every major constituency in this case signed the PSA. The RMBS
2 trustees signed the PSA. The two most significant monolines
3 signed the PSA. The two securities claimants who are on the
4 committee signed the PSA, and there are twenty-one other
5 private securities claimants behind them. The Carpenter's
6 class action signed the PSA or signed an agreement supporting
7 the plan. A creditor representing the borrowers signed the
8 PSA. The trustee for the HoldCo bond signed the PSA. One of
9 the largest creditors in the HoldCos, they signed the PSA. It
10 was comprehensive, Your Honor.

11 And we all know because we've been through this now
12 for many months. The JSNs did not sign the PSA. Regrettably,
13 they did not sign the PSA, but that didn't mean that the plan
14 was designed in a punitive fashion. I recognize that we have
15 not been applauded, but the reality is, and it's relevant to
16 this motion, the plan provides that the JSNs under this plan
17 are receiving par plus pre-petition accrued, in cash, on the
18 effective date. That is extraordinary treatment, far better
19 than the treatment the JSN ad hoc committee agreed to when this
20 case was filed.

21 We can't forget the JSN ad hoc committee signed a PSA
22 on the first day of this case. That PSA provided that they
23 would be paid less than par plus pre-petition accrued; they'd
24 be paid over many, many months; they'd have to liquidate out
25 their collateral; they'd have to bear the risks of the

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1 liquidation. And they agreed to support a plan and that plan
2 was going to waive intercompany claims.

3 To walk in and suggest that somehow this is a surprise
4 is disingenuous. They knew exactly -- they had the best vision
5 of this company's capital structure. And as Mr. Shore said,
6 and it was very telling, he understands that absent the AFI
7 global settlement that was negotiated post-petition, through
8 the mediation, Mr. Shore represented in his argument that the
9 intercompany claims have little or no value.

10 THE COURT: Let me just stop. I want to make sure
11 because it's not a point that I had -- I am keenly aware of the
12 PSA that was signed at the start of the case. I also remember
13 being told that this was a pre-pack. It became clear, almost
14 on the first day, that the reality was going to be very
15 different, and it has been. Are you telling me that the PSA
16 that the JSNs signed provided for a waiver of intercompany
17 claims?

18 MR. ECKSTEIN: Yes, Your Honor. That's what it had.

19 THE COURT: All right.

20 MR. ECKSTEIN: And Your Honor, we're not operating
21 from whole cloth here. We understood the landscape that
22 existed. And the fact of the matter is, we are not proposing
23 to litigate the intercompany claims.

24 THE COURT: Oh, I understand that, Mr. Eckstein.

25 MR. ECKSTEIN: And we're not proposing to litigate the

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1 RMBS claims. We're not proposing to litigate the securities
2 claims. They're being settled as part of a global settlement.
3 And the intercompany claims are part of the settlement, and one
4 of the rationales for the settlement is that the JSNs are
5 getting par plus pre-petition accrued in cash, which means that
6 if they're undersecured, as a matter of law, the JSNs are not
7 entitled to more. So whether or not there is some value in
8 intercompany claims that might belong to their collateral, if
9 they're not oversecured, they're not entitled to more, which is
10 what's baffling to us about the dispute.

11 The plan provides -- and it's frustrating because
12 there's litigation -- the plan provides it in the event the
13 JSNs in fact are oversecured, if it turns out that the hard
14 assets are worth more than their prepetition debt, the plan
15 says they will receive post-petition interest. And we'll have
16 litigation about whether they're oversecured, and I think Your
17 Honor has made it eminently clear that that's going to be
18 resolved prior to or in connection with confirmation.

19 But the intercompany claims, which are integral to the
20 global settlement that was negotiated with the mediator over
21 the past seven months, those are being resolved as part of the
22 global settlement where the JSNs are receiving par plus pre-
23 petition accrued in cash. And we will demonstrate that that is
24 reasonable, and that it is better for the JSNs -- not just
25 other creditors -- better for the JSNs to receive that, rather

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1 than to have this case lose the AFI settlement and be mired in
2 litigation over valueless intercompany claims for the next
3 several years.

4 And if the JSNs want to quarrel with that and
5 basically suggest we'll throw out the AFI settlement and we can
6 basically convert to Chapter 7, and we can have every estate
7 fight for the next several years over the intercompany claims,
8 they can put that case on at confirmation. It's not -- that's
9 all we're talking about. We are not proposing to litigate the
10 merits of the intercompany claims.

11 In the event Your Honor does not approve the global
12 settlement, and if the plan fails, the intercompany claims will
13 be pristine, and they can present whatever method they think is
14 best to litigate those intercompany claims.

15 THE COURT: You agree with Mr. Lee and disagree with
16 Mr. Shore whether the Court is being required to make a finding
17 at confirmation that the intercompany claims are meritless and
18 have no value?

19 MR. ECKSTEIN: I agree with Mr. Lee. I agreed with
20 the way Your Honor articulated it. We are resolving them for
21 settlement purposes at zero. That is what is being proposed.
22 The merits of those claims are not being adjudicated in
23 connection with confirmation. Same way the RMBS claims are not
24 being adjudicated in connection with confirmation.

25 If Your Honor does not confirm the plan, we will have

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1 plenty of litigation over the RMBS claims. They may be more,
2 they may be less; but they're not being adjudicated on the
3 merits. And that is true for many, many issues in this case.

4 And it is true; this is a complex case, but I agree
5 with Mr. Lee. The fact of the matter is that if we do not
6 confirm this plan, and we ultimately devolve into the
7 litigation over all the different intercompany issues, it's
8 likely that at some point there will be a substantive
9 consolidation motion. In which case, the guarantees will
10 disappear, the intercompany claims will disappear, and the JSNs
11 will get far less than they're getting under this plan.
12 That'll be an issue that will be presented, and it'll be one of
13 the factors that the Court will consider in connection with the
14 proposed settlement.

15 So all of these are very, very significant issues, but
16 they're confirmation issues. And this persistent effort to
17 litigate the intercompany claims is something that frankly we
18 will continue to resist.

19 Now, in terms of the motion, Your Honor, I think we
20 tried to lay out as clearly as possible several reasons why we
21 believe this motion is improper. We certainly believe this
22 motion has no basis with respect to the committee, and I don't
23 really believe that the JSNs even tried to make a wholehearted
24 argument that the committee should be disqualified. They
25 didn't even respond to the cases that we put in our brief. But

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1 that to me is really secondary.

2 I believe the motion, in and of itself, should be
3 denied. We believe it is tactical. We believe it is untimely,
4 because the fact of the matter is, the JSNs knew very, very
5 clearly when the mediator was appointed in December, when the
6 CRO was appointed in February, that the purpose of the
7 mediation was to resolve the intercompany issues, including the
8 intercompany claims.

9 That was not something that was lost on the JSNs.
10 They knew full well we were mediating for five months, almost
11 nonstop, to resolve the intercompany issues. And frankly, they
12 had a responsibility to be at the table. And to come now, and
13 say that the parties who were proposing the plan should be
14 disqualified, we believe that's out of bounds.

15 It's one thing to object to the plan. They have a
16 right to object to the plan. But to come today, after having
17 gone through that process, knowing what the mediation was about
18 and suggest disqualification, we believe is out of bounds.

19 We believe that this issue was teed up in connection
20 with the approval of the PSA. And while we did not suggest
21 that the Court approved the merits of the plan, we believe that
22 in connection with the PSA, the Court heard the objections of
23 the JSNs, the Court overruled the objections of the JSNs, and
24 the Court authorized the debtor to go forward with prosecuting
25 the plan that included the global settlement.

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1 And as to the merits, Your Honor, as we've said, we
2 don't believe there is a conflict. We believe that this is a
3 proposed settlement. This is precisely the way the Court dealt
4 with a global settlement of intercompany issues in Charter,
5 where Judge Peck overruled almost precisely this same
6 objection, and said it was appropriate in the context of a
7 settlement for the debtor's board to consider the overall
8 resolution and its impact on multiple debtors rather than
9 looking at each individual creditor or each individual debtor,
10 one-by-one. That was the ruling in Charter and it faced almost
11 the same objection involving how in Charter the Court could
12 settle the intercompany claims as part of a global settlement.

13 We don't believe this is new, and we believe this is
14 the way courts have allowed large, complex resolutions to be
15 considered. We believe this is a case where there is
16 tremendous sort of provisions made for the interests of the
17 JSNs. As I said, the plan specifically leaves open the
18 possibility that they may be oversecured and frankly, there is
19 an opportunity to litigate, and while they have the right to
20 bring whatever motions they want, this does become very
21 tactical because this is all-consuming, and at some point it
22 becomes overkill.

23 So, we're at the juncture where either we're going to
24 settle these issues or we're going to litigate these issues on
25 the merits. And we believe that the Court has a plan before it

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1 that's appropriately presented. The debtor and the committee
2 are co-proponents with the support of the consenting claimants.
3 The Court is not going to be asked to adjudicate the
4 intercompany claims.

5 The Court will be asked to consider, number one,
6 whether the JSNs are over secured; and number two, whether the
7 global settlement that includes the resolution of the
8 intercompany claims as provided in the plan, including the
9 treatment of the JSNs, is reasonable, fair, and appropriate.

10 We absolutely resist the suggestion that there should
11 be a disqualification of the debtor or the committee
12 professionals or of Mr. Kruger at this late stage in the case.
13 And we believe it's time to move forward and resolve these
14 issues one way or the other on the merits. Thank you.

15 THE COURT: Thank you, Mr. Eckstein.

16 Anyone else wish to speak in opposition to the motion?
17 Mr. Moloney.

18 MR. MOLONEY: Good morning, Your Honor. Tom Moloney,
19 on behalf of Wilmington Trust, which is representing the senior
20 unsecured bondholders. I'll be very brief because I think most
21 of the points have been made.

22 First, Your Honor, we agree completely with your
23 formulation of the issue. There is no need for us to have a
24 finding that the intercompany claims are worth zero. No one is
25 seeking that.

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1 Second, as a factual matter, however, the RFC claim --
2 Your Honor may recall, we filed a complaint in saying it was
3 worth nothing before the mediation even started. That was
4 based on information we had that came from the debtor before
5 mediation even started, that that claim was simply a
6 bookkeeping error. And that undoubtedly informed the decision
7 by the junior secured noteholders, pre-petition, to agree to a
8 plan that called for a waiver of all these claims, provided
9 they got the same plan treatment that they're receiving here,
10 except for timing.

11 That plan treatment called for them to be paid by
12 year-end, but it said if they got paid their pre-petition
13 interest plus accrued interest then all the intercompany claims
14 would be waived, even though unsecured creditors would've
15 received substantially less. And that's the other point I
16 would like -- I rose to make, Your Honor.

17 I never understood the conflict here, because at the
18 moment what we have here, the conflict is between unsecured
19 creditors and a purportedly secured creditor. In their
20 capacity as an unsecured creditor, the JSNs are being paid a
21 hundred cents on the dollar. The plan is paying them in full.
22 So they can't claim that we're harming them by this plan in
23 their capacity as unsecured creditors is only in the -- so to
24 stand here before you only in their capacity as purportedly a
25 secured creditor, where they have the burden of proof, not us,

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1 of showing the value of their collateral, which could include
2 potentially some of these claims. At some point, they may
3 carry that burden, though it seems almost impossible for them
4 to do that.

5 But at the moment, there's no fiduciary duty owed by
6 the unsecured creditors' committee to a secured creditor.
7 There's no fiduciary duty owed by the debtors' professionals to
8 any creditor. They owe duties to the estates and the estates
9 are committed to prosecuting this plan, as already set forth.
10 So I think those are the issues I want to raise. Thank Your
11 Honor.

12 THE COURT: Thank you, Mr. Moloney.

13 Anybody else wish to speak in opposition to the
14 motion?

15 MR. WYNNE: Thank Your Honor, Richard Wynne of Jones
16 Day, on behalf of FGIC. Your Honor, along with several of the
17 creditors and Mr. Moloney's client, we filed a short joinder in
18 the oppositions, but I wanted to rise to really address just
19 two or three points.

20 I know that Your Honor preferred to stay away from the
21 tactical point, but I actually can't avoid it. And I can't
22 avoid it for a very simple reason, that I was one of the --
23 I'll call it unfortunate souls who lived through the six or
24 seven years of the Adelpia wars. And this is a game that we
25 have seen before, and in Adelpia, where we did have years of

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1 intensive litigation over intercompany claims --

2 THE COURT: Let me just stop you, Mr. Wynne. This is
3 not going to be six or seven years of litigation.

4 MR. WYNNE: Thank you.

5 THE COURT: Full stop.

6 MR. WYNNE: But my --

7 THE COURT: Go ahead.

8 MR. WYNNE: -- my point, Your Honor, was that midway
9 through that litigation Judge Gerber effectively called a halt
10 and appointed a mediator, and appointed Judge Morris to mediate
11 what ultimately became a largely global resolution. I believe
12 that Mr. Shore's clients were -- they were part of that
13 settlement. Another group of creditors opposed confirmation.

14 But what we effectively have here is that the debtor
15 and the committee and all the other professionals that were
16 involved -- Mr. Kruger -- through the mediation that Your Honor
17 entered, we short-circuited that first step. And I think
18 that's a valuable thing to notice.

19 The other important point is that the prepetition PSA
20 that a majority of the JSNs signed, or the ad hoc group signed
21 and supported, included only the 750-million-dollar
22 contribution from AFI. And a key component that we can't lose
23 sight of is that this global settlement brings in 2.1 billion
24 dollars. And I believe the numbers in the disclosure statement
25 are that it's expected that there will be about 2.6 billion

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1 dollars distributed to unsecured creditors in this case. And
2 2.1 of that, the vast majority of that, is coming from the AFI
3 settlement. So that was part of the components of the global
4 mediation that critically, we think, actually resolved any
5 potential conflicts that existed here. And we think that was
6 the appropriate way to proceed. Thank you, Your Honor.

7 THE COURT: Thank you very much, Mr. Wynne.

8 Anybody else wish to speak in opposition to the
9 motion?

10 Mr. Shore?

11 MR. SHORE: Thank Your Honor. Let me first clarify a
12 couple of points. With respect, you asked the direct question
13 about the prepetition PSA. The treatment of intercompany
14 claims which comes on page 10 of that is not what Mr. Eckstein
15 said it was. In fact, it says, "Unless the junior secured
16 claims have been paid in full, based upon their secured claim,
17 allowed" -- defined -- "intercompany claims shall receive in
18 full satisfaction of all such allowed intercompany claims an
19 amount equal to its pro rata share of ResCap unsecured claims
20 pool." In other words, in the absence of payment in full, the
21 issue was punted as to whether or not the intercompany claims
22 would or would not be subject to allowance at a later date.

23 And responding to statements made by both the
24 committee and Mr. Wynne there, about the import of the
25 prepetition PSA, just for the record, thirty-eight percent of

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1 the ad hoc group at that time, a substantial portion of that is
2 no longer members of our group and actually members of the
3 senior unsecured notes-- because there was a big trade-out in
4 positions -- were the ones who signed that. But I don't need
5 to get in -- and I hope I don't need to get into the merits of
6 the underlying litigation right now. We've got a litigation
7 going on. What we're asking is that the litigation be
8 conducted in accordance with the rules.

9 THE COURT: Mr. Shore, a point on which there's strong
10 disagreement between you on the one hand, Mr. Lee and Mr.
11 Eckstein on the other, is the issue of whether the Court is
12 being asked to make a finding at confirmation that the
13 intercompany claims have a value of zero as opposed to how I
14 framed the question during your argument-in-chief.

15 And Mr. Lee and Mr. Eckstein have responded quite
16 directly that the Court is not being asked to litigate and
17 value the intercompany claims. Rather, the global settlement
18 proposes a settlement of it. Do you have a document you can
19 point me to that supports your statement that I am being asked
20 to make a finding about the value of each intercompany claim?

21 MR. SHORE: No, but I can, but I will say this --

22 THE COURT: No, I -- look, you said one thing.

23 MR. SHORE: No, I --

24 THE COURT: They said the other. I'm asking you, you
25 got something to back it up?

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1 MR. SHORE: Right, and I'll tell you this. After we
2 filed the motion, we had our calls last week. The debtors
3 didn't engage. I engaged with the committee. I will tell you
4 if it ever comes to a question as to whether this motion was
5 filed in good faith, I will submit a declaration to this Court
6 with respect to that conversation in which the opposite --

7 THE COURT: Let's deal with the issues I have before
8 me today.

9 MR. SHORE: Right.

10 THE COURT: I've made clear I'm not resolving an issue
11 of bad faith. I have questions about it.

12 MR. SHORE: Um-hum.

13 THE COURT: I'm not resolving that today, but -- okay.
14 You've --

15 MR. SHORE: So --

16 THE COURT: -- answered my question. Go on.

17 MR. SHORE: So maybe there's a miscommunication
18 between --

19 THE COURT: Look --

20 MR. SHORE: -- the litigation team --

21 THE COURT: -- just go on to your next point.

22 MR. SHORE: Well this, this is important because what
23 has been --

24 THE COURT: It is important --

25 MR. SHORE: Right.

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1 THE COURT: -- because you said definitively that I
2 was being asked to make a finding -- that I was being told I
3 had to make a finding valuing the intercompany claims at zero.
4 I've asked this question. There's a record, and I think both
5 the co-proponents are quite clear that not being asked to make
6 such a finding. So let's go on to the next point.

7 MR. SHORE: Good. And what they have described is
8 what we asked in the motion in which they were not --

9 THE COURT: Could you go on to your next point?

10 MR. SHORE: This is -- this is my next point. They
11 have essentially agreed that what we said is they're going
12 to --

13 THE COURT: Mr. Shore --

14 MR. SHORE: -- appear neutrally.

15 THE COURT: -- are you not listening to me? This
16 issue, as far as I'm concerned, is put to rest. Go on to your
17 next point in rebuttal.

18 MR. SHORE: My last point on rebuttal is the only
19 piece of neutrality that is not addressed when they say we are
20 not seeking a finding and we're not going to be litigating the
21 issue as to whether the claims are worth zero, is what we're
22 going to do about the discovery in asso -- in connection with
23 that or anything else. I think the answer to the question was
24 they are going to be claiming privilege on advice they gave to
25 conflicting counsel --

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1 THE COURT: I don't think I got -- I don't think I --

2 MR. SHORE: -- we'll deal with at a later --

3 THE COURT: -- I don't think that point was raised.

4 I'm going to deal with the discovery disputes today. But I
5 asked a question; you indicated there's a statement in the
6 disclosure statement. I didn't see it. That's why I ask about
7 it. Could you point me to a specific --

8 MR. SHORE: Yeah, I --

9 THE COURT: -- statement in --

10 MR. SHORE: -- I thought --

11 THE COURT: -- the disclosure statement?

12 MR. SHORE: I'm -- I apologize. I did not bring the
13 disclosure statement. There is a passage when discussing
14 intercompany claims which discusses the advice that was
15 provided in presentations that were made. I think the answer
16 was it's not one memorandum -- my problem -- but multiple
17 presentations which were made to Mr. Kruger on the issue.

18 THE COURT: If and when the issue arises in discovery,
19 I'll deal with it at that time.

20 MR. SHORE: That's -- so as I was saying, that issue
21 moves off. But what the debtors are saying and what the
22 committee have said today, which is something they've never
23 said before in court is they are not going to be doing this.
24 That resolves --

25 THE COURT: Mr. Shore --

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1 MR. SHORE: -- the substantial portion --

2 THE COURT: -- what is it about what I've said you
3 don't understand? Okay. You sound like a broken record on
4 this. It was an important point you raised. I asked the
5 question of both Mr. Lee and Mr. Eckstein. They responded
6 quite directly. There'll be a transcript available. Go on to
7 your next point.

8 MR. SHORE: The only, then, point is we'll leave
9 discovery for a later date, and with respect to the adequacy of
10 the disclosure, we'll raise it in the context of a disclosure
11 statement objection to the extent that we have issues with the
12 level of disclosure around the treatment of intercompany
13 claims.

14 THE COURT: All right. Any other -- anything else you
15 want to raise?

16 MR. SHORE: Nothing else, Your Honor.

17 THE COURT: All right. It's 11:30. We're going to
18 take a recess of about twenty minutes or so, approximately, and
19 I'm going to rule from the bench.

20 (Recess from 11:27 a.m. until 11:57 a.m.)

21 THE COURT: Please be seated.

22 Pending before the Court is the motion of the ad hoc
23 group of junior secured noteholders for entry of an order
24 (i) directing each of the debtors' counsel, including Morrison
25 & Foerster LLP, official committee counsel including Kramer,

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1 Levin, Naftalis & Frankel LLP, and the debtors' management to
2 remain strictly neutral in any dispute regarding claims by and
3 between any debtors, (ii) ordering the limited disqualification
4 of each of the foregoing to the extent necessary to effectuate
5 the foregoing, and (iii) granting related relief. I'll refer
6 to this as the motion. It's at ECF 4282.

7 Dwight A. Healy submitted a declaration in support of
8 the motion. It's at ECF docket number 4290.

9 On Friday, July 26, 2013, the following parties filed
10 objections. The debtors, see ECF docket number 4368; the
11 committee ECF docket number 4372; joined by certain consenting
12 creditors ECF docket number 4371; and Ally Financial, Inc. ECF
13 docket number 4369.

14 The ad hoc group filed its reply on Monday, July 29th,
15 2013, ECF docket number 4389.

16 For the reasons I will explain on the record and may
17 follow up with a written opinion after I've had an opportunity
18 to review the transcript, the motion is denied.

19 The ad hoc group has been engaged in a pitted battle
20 with the debtors and the creditors' committee over the proposed
21 treatment of the junior secured noteholders -- I'll refer to
22 them as the JSNs -- in any plan of reorganization in this case.
23 The currently filed proposed plan contends that the JSNs are
24 undersecured but proposes to pay JSNs all pre-petition
25 interest and principal. The JSNs claim that they are

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1 oversecured and therefore they are also entitled to post-
2 petition interest and fees as well.

3 The debtors and the committee have filed adversary
4 proceedings against the JSNs seeking a determination that the
5 JSNs are undersecured. The two cases have been consolidated
6 for trial, with the issues bifurcated, and the first-phase
7 trial, likely to occur in early October, 2013.

8 The proposed reorganization plan that is on file is
9 the result of a successful mediation conducted by my colleague,
10 Honorable James M. Peck, over many months. The direct result
11 of the mediation is a plan support agreement -- I'll refer to
12 it as the PSA -- by and between numerous creditor
13 constituencies in this large and complex case. The parties to
14 the PSA agree to support a plan consistent with the terms of
15 the PSA and its two attached term sheets. Because the members
16 of the ad hoc group refuse to agree to sign a nondisclosure
17 agreement required before members of the ad hoc group could
18 participate in the confidential mediation, the members of the
19 ad hoc group did not participate in the mediation; they are not
20 signatories to the PSA.

21 I would note that on July 26, 2013, the Court approved
22 the ad hoc group's motion for an order in aid of mediation.
23 With the signing of the order, members of the ad hoc group
24 agreed to sign an NDA and engage in mediation before Judge
25 Peck.

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1 Among the terms of the PSA and of the proposed
2 reorganization plan, is a proposed settlement agreed upon by
3 all parties to the PSA of all interdebtor claims for settlement
4 purposes, valuing them at zero. That result may potentially
5 affect whether the JSNs are over- or undersecured, and thus,
6 whether they are entitled to post-petition interest and fees.

7 In support of this proposed settlement the parties to
8 the PSA argue that this settlement resolves disputed issues
9 that would be expensive and time-consuming to litigate. Thus,
10 the parties to the PSA, including the debtors and the
11 creditors' committee, argue that this settlement is fair,
12 reasonable, and in the best interests of the debtors' estates
13 and their creditors. Whether the settlement is approved will
14 be an issue at confirmation.

15 Since the announcement of the signing of the PSA,
16 which was approved by the Court over the objections of a number
17 of parties, the ad hoc group, through its counsel, has worked
18 tirelessly to blow up the PSA and the entire case. The current
19 motion to disqualify counsel and debtors' CRO is only the
20 latest of many actions taken by the ad hoc group to derail this
21 case.

22 The Court wants to make clear, however, that many
23 issues arising from the currently proposed plan, including the
24 proposed settlement of interdebtor claims, are a fair ground
25 for litigation in the context of the Rule 9019 standards. And

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1 as the Court has made clear on numerous occasions, those issues
2 will be the subject of future proceedings. This Court has not
3 prejudged any of the issues.

4 The question raised by this motion is the tactics
5 adopted by the ad hoc group to short-circuit the normal
6 litigation process that will be followed in this case. The
7 timing of the filing of this motion raises substantial
8 questions whether the ad hoc group and its counsel have acted
9 in bad faith in filing the motion.

10 Members of the ad hoc group, primarily hedge funds,
11 previously declined to sign an NDA because they did not want to
12 become restricted from trading the debtors' securities.
13 Litigation conduct, such as the filing of the motion, that
14 threatens to derail confirmation of the proposed plan, has the
15 potential to affect the market price of the debtors'
16 securities. Any trading by members of the ad hoc group upon
17 the filing of the motion may be relevant to the issue whether
18 motion was filed in bad faith. The Court intends to defer
19 consideration whether the motion was filed in bad faith. Until
20 this case is concluded, that issue is expressly reserved.

21 The ad hoc group seeks an order: a) directing each of
22 the debtors' counsel, Morrison & Foerster, counsel to the
23 committee, including Kramer Levin, and the debtors' management
24 and chief restructuring officer, Lewis Kruger, to remain
25 strictly neutral in any dispute in this court regarding claims

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1 by and between any debtors; b) ordering the limited
2 disqualification of each of the forgoing to the extent
3 necessary to effectuate the forgoing; c) granting related
4 relief; and d) awarding the ad hoc group such other and further
5 relief as the Court deems appropriate.

6 It is important that issues raised by this motion be
7 resolved quickly in light of the expedited schedule in this
8 case. Therefore, for purposes of this ruling, the Court will
9 not recount all of the arguments raised by the parties in the
10 pleadings filed in support of and in opposition to the motion.
11 All arguments have been considered by the Court.

12 Section 327 of the Bankruptcy Code mandates that
13 counsel must be free of conflicts of interest in its
14 representation of an estate. Section 327 imposes a two-pronged
15 test for the initial retention and continued employment of
16 professionals. The professionals, 1) must not hold or
17 represent any interest adverse to the estate, and 2) must be
18 disinterested persons. See Bank of Brussels Lambert v. Coan,
19 that's C-O-A-N; In re Aerochem Corp., 176 F.3d 610, 620-21 (2d
20 Cir. 1999); Bergrin v. Eerie World Entertainment, LLC, number
21 03 Civ. 4501(sas), 2003 WL 22861948 at *1, (S.D.N.Y., December
22 2, 2003); In re Vebeliunas, that's V-E-B-E-L-I-U-N-A-S, 231
23 B.R. 181. 188 (Bankr. S.D.N.Y. 1999); In re Granite Partners,
24 L.P., 219 B.R. 22, 32-34 (Bankr. S.D.N.Y. 1998).

25 When read in conjunction with the definition of

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1 "disinterested person" contained in Section 101, Subsection
2 (14)(c), which includes the requirement that the person not
3 have an interest materially adverse to the estate or any class
4 of creditors or equity holders, however, Section 327(a)
5 provides a single test to assess conflict. See In re JMK
6 Construction Group, Ltd., 441 B.R. 222, 229, (Bankr. S.D.N.Y.
7 2010).

8 That test is whether the professional holds or
9 represents "an interest adverse to the estate." Aerochem
10 Corp., 176 F.3d at 622-23.

11 An adverse interest is either, 1) the possession or
12 assertion of any economic interest that would tend to lessen
13 the value of bankruptcy estate or create an actual or potential
14 dispute with the estate as a rival claimant; or 2) a
15 predisposition of bias against the estate. See Aerochem Corp.,
16 176 F.3d at 623; JMK Construction Group, Ltd., 441 B.R. at 229;
17 Granite Partners, L.P., 219 B.R. at 33.

18 The determination of adverse interest is objective and
19 it's concerned with the appearance of impropriety. JMK
20 Construction Group, Ltd., 441 B.R. at 229.

21 A professional has a disabling conflict if it has
22 "either a meaningful incentive to act contrary to the best
23 interests of the estate and its sundry creditors -- an
24 incentive sufficient to place those parties at more than
25 acceptable risk -- or the reasonable perception of one."

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1 Granite Partners, L.P., 219 B.R. at 33.

2 The "requirements of Section 327 must be taken
3 seriously as they ensure that a professional fulfils his duties
4 in accordance with his fiduciary duties to the estate." JMK
5 Construction Group, Ltd., 441 B.R. at 230.

6 As this Court further noted in JMK, "Courts lack the
7 power to authorize the employment of a professional who has a
8 conflict of interest." Id.

9 Nonetheless, it is standard practice to allow one law
10 firm to represent multiple debtors even when intercompany
11 claims exist, in order to conserve estate assets. See In re
12 International Oil Co., 427 F.2d 186, 187 (2d Cir. 1970). (The
13 existence of intercompany claims by itself is not a basis "to
14 saddle these estates with the expense of separate trustees and
15 trustees' attorneys."); In re BH&P, Inc., 949 F.2d 1300, 1310
16 (3d Cir. 1991). (Recognizing that a single representative of
17 multiple estates "is often able to maximize the return to
18 jointly administered estates through increased economy and
19 efficiency."); In re Global Marine, Inc., 108 B.R. 998, 1004
20 (Bankr. S.D.Tx. 1987), holding that, "The mere existence of an
21 intercompany claim does not in and of itself constitute an
22 impermissible conflict of interest that would justify
23 disqualification").

24 The issues raised by a single counsel representing
25 multiple debtors in a single case is far different than the

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1 issue addressed by this Court in In re Project Orange
2 Associates LLC, 431 B.R. 363 (Bankr. S.D.N.Y. 2010).

3 In Project Orange, the Court refused to approve the
4 retention of DLA Piper because in addition to representing the
5 debtor, the firm also represented in unrelated matters, the
6 largest creditor in the bankruptcy case. The creditor's claims
7 were disputed and unliquidated. A settlement of the claim was
8 critical to any successful reorganization of the debtor. The
9 Court concluded that the representation of the debtor and the
10 largest creditor in the case precluded DLA Piper's retention as
11 general bankruptcy counsel.

12 Adelphia is an instructive case. In Adelphia, Judge
13 Gerber reviewed sixteen different multi-debtor cases where
14 interdebtor disputes existed, and found that representation by
15 a single firm in such circumstances was a common and
16 appropriate practice. See In re Adelphia Communications Corp.,
17 336 B.R. 610, 645-53 (Bankr. S.D.N.Y. 2006), affirmed 342 B.R.
18 122 (S.D.N.Y. 2006). See also the transcript in In re General
19 Growth Properties, Inc., number 09-11977-alg, Bankruptcy Court,
20 Southern District of New York, it's docket number 90 -- excuse
21 me -- docket number 72, transcript at page 38. (Court referred
22 to proposition that requiring each separate debtor to have
23 separate counsel "would be an absurdity").

24 Judge Gerber ultimately held that appointing a Chapter
25 11 trustee or directing the recusal of the debtor's officers

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1 and directors, and ordering the appointment of independent
2 fiduciaries was not warranted. To quote from the case, "To the
3 contrary, it is clear in this Court's view under the Bankruptcy
4 Code and the case law that there is no requirement of law, nor
5 should there be one, that says that any time interdebtor
6 disputes exist in a multi-debtor Chapter 11 case, and a
7 creditor constituency is upset that it may not be paid in full,
8 independent fiduciaries (of any kind) must be appointed per any
9 or all of the individual debtors so affected. The imposition
10 of any such requirement would represent a sea-change in the law
11 and in Chapter 11 practice with a highly destructive effect on
12 the manner in which multi-debtor Chapter 11 cases are run. As
13 importantly or more so, any such rule would in nearly all if
14 not all such cases have a material adverse effect on creditor
15 recoveries." 336 B.R. at 618.

16 Judge Gerber did find that debtors' counsel was
17 disqualified only for the limited purpose of representing the
18 debtor in the litigation -- I emphasize litigation -- between
19 certain subsidiaries of the debtor; I'll refer to those as
20 intercreditor disputes.

21 Judge Gerber found that "no relief beyond requiring
22 neutrality on the interdebtor disputes themselves is
23 warranted," but that "now that the interdebtor disputes are in
24 litigation, debtors' counsel cannot act on both sides of the
25 litigated controversy." 336 B.R. at 672-73.

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1 The Court also noted that the debtors' counsel "can
2 continue to act as a facilitator to privately try to assist the
3 creditor groups whose money is at stake, to reach a
4 settlement." Id. at note 173.

5 In WorldCom, the court confirmed a Chapter 11 plan
6 that eliminated most intercompany claims because "resolution of
7 these disputes by virtue of the differing treatment of
8 differently situated classes of unsecured creditors, as
9 provided in the plan, avoids potentially massive and protracted
10 litigation over the following issues: the precise allocation
11 of assets and liabilities among entities; the enforcement or
12 validity of different types of intercompany claims; and the
13 amount of intercompany claims." In re WorldCom, Inc., 2003 WL
14 23861928 at *32, (Bankr. S.D.N.Y. October 31, 2003).

15 Similarly in Enron, the court confirmed a Chapter 11
16 plan that settled intercompany claims because "the global
17 compromise benefits all creditors by, inter alia, reducing the
18 potential costs of litigation including the costs of performing
19 diligence regarding a multitude of underlying facts and
20 transactions, the professional fees associated with the
21 litigation, the delays and uncertainty associated with
22 litigation, the prolonged costs of administering the estates,
23 the resulting depletion of the estates' assets, as well as
24 creditors' lost time value of money resulting from later
25 distributions." See findings of fact and conclusions of law

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1 confirming supplemental modified fifth amended joint plan of
2 affiliated debtors pursuant to Chapter 11 of the United States
3 Bankruptcy Code and related relief, In re Enron Corp., number
4 01-16034-ajg, Bankruptcy Court Southern District of New York,
5 July 15, 2004, docket entry 19758 at pages 78-79.

6 Neither court required each individual debtor to
7 retain separate counsel to resolve interdebtor claims.

8 Courts have also denied disqualification motions based
9 in part on the fact that the motion was brought as a litigation
10 tactic. See, e.g., In Re Enron Corp., number 01-16034-ajg,
11 2002 WL 32034346 at *1, (Bankr. S.D.N.Y., May 23, 2003) -- I'll
12 refer to that as Enron 2 -- affirmed number 02 Civ. 5638 (bsj),
13 2003 WL 223455 at *4 note 2, (S.D.N.Y., February 3, 2003),
14 (Denying a disqualification motion three months into the case
15 because "delay in bringing any action to disqualify counsel is
16 generally frowned upon because of the disruption it would cause
17 to the case."); In re O.P.M. Leasing Services, Inc., 16 B.R. at
18 938-41; In re WorldCom, Inc., 311 B.R. 151 (Bankr. S.D.N.Y.
19 2004) -- I'll refer to that as WorldCom 2 -- (Denying
20 disqualification motion relating to debtors' auditors and tax
21 advisors on the eve of debtors' emergence from bankruptcy in
22 stating that, "the creditors acted in connection with a
23 litigation strategy that served their own pecuniary interest"
24 and "the delay in bringing the disqualification motion until
25 the eve of the debtors' emergence from bankruptcy was

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1 potentially disruptive to the debtors' reorganization; the
2 interests of all creditors in these Chapter 11 cases would have
3 been hindered by the disqualification as emergence could have
4 been delayed without any foreseeable benefit to the debtors'
5 estates.")

6 The motion here must be denied. While the ad hoc
7 committee attempts to make a distinction between what they are
8 asking for, an order of neutrality, and a substantive
9 disqualification motion, it is clear that the ad hoc group
10 intends to hamstring the co-proponents of the reorganization
11 plan from proceeding to seek confirmation of any plan that
12 settles interdebtor claims on any basis not to the liking of
13 the JSNs. The ad hoc group says in its reply that "no one has
14 suggested that this conflict be resolved through the
15 appointment of fifty-plus sets of separate professionals or
16 trustees." But that is the ineluctable conclusion that follows
17 from the ad hoc group's arguments.

18 Moreover, one of the issues at the heart of this
19 dispute is the ad hoc group's "misunderstanding" -- and I'll
20 put that term in quotes -- of the debtors' reasoning for
21 settling intercompany claims at zero. The ad hoc group
22 repeatedly argues that the debtors are impermissibly seeking a
23 determination from the Court that the intercompany claims have
24 no value and that the settlement of such claims for zero is
25 inappropriate.

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1 This significantly misstates the debtors' and the
2 committee's position. The Court specifically addressed this
3 issue during argument and the answer by counsel to the debtors
4 and the committee could not have been clearer; the Court is not
5 being asked to determine the value of the interdebtor claims.
6 The debtors do not argue that the intercompany claims have no
7 value. They are arguing that 1) it is in the best interests of
8 the estates to avoid the cost, time, and burden, of litigating
9 hundreds if not thousands of intercompany claims; and 2) that
10 it is in the best interest of the estates to seek confirmation
11 of a plan that embodies the terms of the PSA.

12 In other words, what the ad hoc group misses and the
13 debtors acknowledge is the intercompany claims may have value,
14 but they believe that the estate will realize more value by
15 settling those claims at zero because doing so is a requirement
16 for AFI to provide its substantial contribution under the terms
17 of the PSA.

18 For the reasons I have explained, and after reviewing
19 the transcript I'll decide whether to supplement it with a
20 written opinion, the motion is denied. An order will be
21 entered today denying the motions for the reasons stated on the
22 record.

23 All right. Court is adjourned.

24 (Whereupon these proceedings were concluded at 12:23 p.m.)
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RULINGS

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7

Noteholders for Entry of an Order, (i)

8

Directing Each of the Debtors' Counsel

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Including Morrison & Foerster LLP, Official

10

Committee Counsel Including Kramer, Levin,

11

Naftalis & Frankel LLP, and the Debtors'

12

Management to Remain Strictly Neutral in any

13

Dispute Regarding Claims by and Between Any

14

Debtors, (ii) Ordering the Limited

15

Disqualification of Each of the Foregoing to

16

the Extent Necessary to Effectuate the

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Foregoing, and (iii) Granting Related Relief

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is Denied

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C E R T I F I C A T I O N

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4

I, Penina Wolicki, certify that the foregoing transcript is a
5 true and accurate record of the proceedings.

6

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Penina Wolicki

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11

PENINA WOLICKI

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AAERT Certified Electronic Transcriber CET**D-569

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Date: July 31, 2013

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